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ADVISORY

# Geopolitics, Trump, and the Fed

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Our weekly view on asset allocation.

20 June 2025

# Trump ups the stakes on Israel and Iran

Tensions between Israel, Iran, and the United States have escalated significantly in recent weeks and days, marking a potentially critical juncture in Middle Eastern and global geopolitics.

Israel launched a large-scale attack on Iran on June 13, targeting nuclear and energy infrastructure. This prompted swift retaliation from Iran.

The conflict has caused a spike in risk aversion in global financial markets. Equities have pulled back, while oil prices have surged. Gold has also received some renewed buying. The impact so far on US bond yields and the US dollar has been relatively muted.

The attacks mark the second military confrontation between Iran and Israel in just over a year. In the previous episode, both sides showed restraint. This conflict, however, is looking more serious.

So far, the downdraft in stocks has been measured, consistent with the view that markets do not have a central case of a protracted and widening war with a damaging impact on the global oil supply.

**Figure 1: Global and domestic equities have pulled back as Middle Eastern tensions rise**



Source: Refinitiv, Wilsons Advisory.

**Figure 2: Middle Eastern conflicts can have significant impacts on oil prices and inflation**



Source: Refinitiv, Wilsons Advisory.

## US Threatens to Escalate the Conflict

However, with the US now threatening to become involved, tail risks appear to be rising and bear close watching. The Wall Street Journal reported in the middle of last week that President Trump and his team were considering options that included joining Israel in strikes against Iranian nuclear installations.

The US holds critical capabilities in terms of taking out Iran's enrichment facilities buried deep underground. Specifically, a significant strategic blow to Iran's nuclear ambitions would require dropping bunker-busting bombs on the Fordow Fuel Enrichment Plant - the centre piece of Iran's nuclear program. Only the US has that capability. Trump has said he is considering such a strike, which would represent a major escalation for the United States.

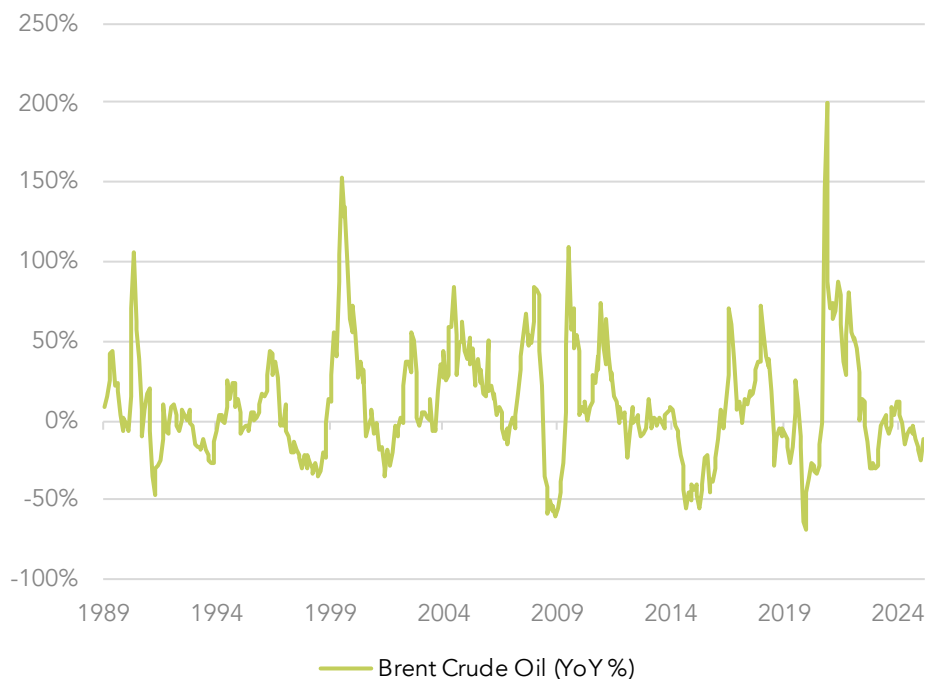
President Trump was somewhat ambiguous in his comments on Wednesday the 18th on whether the US will join Israel's bombardment of Iranian nuclear and missile sites. "I may do it. I may not do it. I mean, nobody knows what I'm going to do," Trump said to reporters outside the White House.

Offering some hope for negotiations, Trump in later remarks said Iranian officials wanted to come to Washington for a meeting and that "we may do that." He added, however, that, "it's a little late" for such talks.

On the 19th of June the White House said US President Donald Trump will make a decision within the next two weeks on whether to become involved in the conflict.

Iran appears to be exploring options for leverage, including veiled threats to hit the global oil market by restricting access to the Gulf through the Strait of Hormuz. This is the world's most important shipping lane for oil, through which 20% of global oil consumption and 25% of LNG flows daily. So the situation is delicately poised.

**Figure 3: Despite the recent spike, the oil price is currently still lower than it was a year ago**



Source: Refinitiv, Wilsons Advisory.

## Middle Eastern Tensions Usually Fade (but not always)

While Middle Eastern tensions have tended to fade without major impact in recent years, conflicts in the early 1970s and early 1980s caused oil prices to surge and subsequently led to major inflationary shocks. In addition, the Russian invasion of Ukraine in 2022 caused a large spike in oil and gas prices that fed into global inflation. So tail risks around the Israel/Iran conflict are not insignificant, given the potential implications for the oil market.

Whether it proves to be truly inflationary will be a function of the magnitude and duration of the oil price rise, with a decision by the US to escalate or de-escalate likely the key. President Trump has been vocal in his desire for lower oil prices, but the US administration may perceive it has a window to significantly impair Iran's nuclear capabilities.

# A Tense Two Weeks

In summary, potential US involvement in Israel's military campaign against Iran, is raising near-term risks to oil supply and global financial market stability. Iran may retaliate by targeting regional oil production and/or transport routes, especially if the US launches direct strikes.

A US assault would aim to dismantle Iran's nuclear program, not the regime itself, but the regime's capacity to disrupt oil flows remains the critical risk. Closure of the Strait of Hormuz is a significant risk unless the US can effectively preempt Iranian moves, which remains uncertain.

While Iran may attempt to revive negotiations given the two-week window, the US administration may perceive it has a chance to significantly impair Iran's nuclear capabilities and aim to play hardball with Iran. Consequently, it is difficult to back an outcome with certainty. We see the current delicate state of play as another reason to have some tactical caution around equities after a strong run-up, and continue to hold gold as a portfolio hedge.

Figure 4: US Federal Reserve Board Economic Projections (less growth, more inflation)

	2025	2026	2027
Real GDP			
June	1.4	1.6	1.8
March	1.7	1.8	1.8
Unemployment			
June	4.5	4.5	4.4
March	4.4	4.3	4.3
Core Inflation (PCE)			
June	3.1	2.4	2.1
March	2.7	2.2	2
Fed Funds Rate			
June	3.9	3.6	3.4
March	3.9	3.4	3.1

Source: Refinitiv, Wilsons Advisory.

## US Fed Happy to Sit on the Sidelines for Now

From a domestic policy perspective, the US FOMC left rates unchanged at their meeting last week, but the Fed did shift their economic projections at the margin.

The Fed revised its forecast for headline and core inflation higher this year and next, while nudging its forecast for GDP growth lower.

The median assumption of appropriate policy (the "dot plot") for 2025 was left unrevised at ~3.9%. However, 2026 was revised up 25bp to ~3.6%, and up 25bp to ~3.4% at the end of 2027.

At his press conference Powell downplayed the significance of the dot plot, saying it lacked "great conviction," which suggests the Fed is not firmly committed to any specific rate path.

Chair Powell reiterated the outlook is highly uncertain, but with the economy solid and the labour market doing well in his view, the FOMC believes it has the luxury of waiting.

"Because the economy is still solid, we can take the time to actually see what's going to happen," said Chair Powell.

He believes policy is well-positioned to respond to risks that may be realized. "The current stance of monetary policy leaves us well positioned to respond in a timely way to potential economic developments."

Powell suggested any adjustments to forecasts would depend heavily on tariff policy and its impact. He downplayed the notion that broader fiscal policy would have much impact.

While Powell did not directly critique fiscal policy decisions, he did highlight how tariffs are complicating the Fed's ability to forecast and respond appropriately. This suggests the Fed will lean towards being reactive rather than proactive.

## Powell's Term as Fed Chair Due to End May 2026

Chair Powell's patient stance and reserved comments come as U.S. President Donald Trump continues to snipe from the sidelines. "So we have a stupid person, frankly, at the Fed" said President Trump post the Fed's on-hold decision.

Trump has also recently said that he could soon nominate Jerome Powell's successor, with nearly a year left before the Federal Reserve chair's term ends. This could further increase uncertainty for markets.

Trump has been regularly voicing his displeasure with Powell and the Fed for not lowering interest rates since the president began his second term in January.

While Trump has backed off from comments earlier this year that he might fire Powell, he said earlier this month that a decision on the next Fed chair could be coming soon.

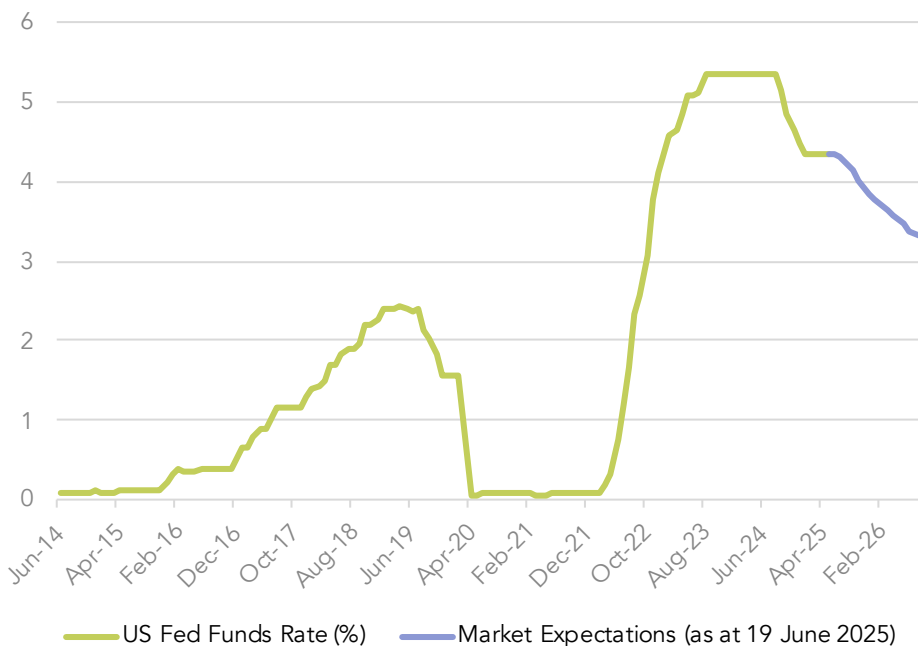
The potential for a "shadow" Fed chair who offers potentially clashing views with the sitting central bank leader on monetary policy could contribute to market confusion. In addition, any choice deemed as being a Trump insider would alarm markets, given the broad sentiment that an independent Fed is critical to its ability to function properly.

The Fed Chair is only one of 18 members on the central bank's monetary policymaking committee and a key part of the role is to build consensus on the committee.

Widely discussed candidates are Fed Governor Christopher Waller; White House economic adviser Kevin Hassett; former Fed Governor Kevin Warsh; Judy Shelton - a former Trump pick for the Fed board whose nomination was withdrawn under President Joe Biden; and current Treasury Secretary Scott Bessent.

One mitigating factor is that a Fed Chair would need to be confirmed by the US Senate, a process that could take months from the time of Trump's announcement. So, for now, Chairman Powell will remain the loudest voice on US monetary policy, despite President Trump's periodic sniping from the sidelines.

**Figure 5: The market expects the Fed to cut again in September and lower rates progressively over the coming year**



Source: Refinitiv, Wilsons Advisory.

## Trump Making Life Difficult for the Fed but More Cuts Still Likely

The market continues to see the September 17 meeting as a probable re-start of the Fed's easing cycle, with two cuts this year and two next year. This is a little more dovish than the Fed's dot plot, but as discussed, the Fed does not have strong conviction given the unusual amount of uncertainty around geopolitics and tariff policy. However, the likelihood that rates are more likely to come down than go up over the coming year, alongside a base case of no recession, keeps us constructive on US and Australian equities on a 12-month view, despite some near-term caution.

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